

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:4-PLR-114717-02

Date:

JULY 19, 2002

Re:

Legend:

Father =

Father's Trust =

Daughter =

Daughter's Trust =

Stepgrandchild 1 =

Stepgrandchild 2 =

Stepgrandchild 1 Family Trust No. 2 =

Stepgrandchild 2 Family Trust No. 2 =

Stepgreatgrandchild 2a =

Stepgreatgrandchild 2b =

Stepgreatgrandchild 2c =

Stepgreatgrandchild 2a Separate Trust No. 2 =

Stepgreatgrandchild 2b Separate Trust No. 2 =

Stepgreatgrandchild 2c Separate Trust No. 2 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

Date 9 =

Year =

State =

Dear :

This is in response to your submission dated July 12, 2002 on behalf of Stepgreatgrandchild 2a Separate Trust No. 2, in which you request a ruling that the exercise of a power of appointment will not cause the trust to be subject to the generation-skipping transfer tax under § 2601 of the Internal Revenue Code.

On Date 1, prior to September 25, 1985, Father established Father's Trust, for the benefit of Daughter. Under the terms of Father's Trust, after Daughter attained the age of 21, all net income was to be paid to Daughter for her life. On Daughter's death, the trust corpus was to be held for the benefit of Daughter's children. However, if Daughter died without children surviving, the trust corpus was to be paid to Father, or his estate. In addition, Father retained the right to revoke the trust, in which case, the corpus was to be paid to Father.

On Date 3, prior to September 25, 1985, Father released his retained right to revoke the trust. Subsequently, on Date 4, prior to October 21, 1942, Father and the trustee of Father's Trust executed an "Agreement" pursuant to which Father, Daughter and the trustee of the trust consented to the amendment of Father's Trust to provide that should Daughter die with no children surviving, then the principal of the trust was to be distributed to such person or persons as Daughter shall direct pursuant to the terms of her last will. It is represented that this agreement amending the trust was effective under State law authorizing the modification of a trust if the grantor, trustee and beneficiaries consent to the modification, or alternatively, effectuated an assignment of Father's reversionary interest. On Date 5, prior to November 1, 1951, Daughter released her rights under the power of appointment granted in the Date 3 Agreement, except the right to appoint to her spouse, her descendants, the descendants of her spouse, or the spouses of her descendants.

On Date 6, Daughter amended and restated a revocable trust, Daughter's Trust, that she had previously established. In addition, on Date 6, Daughter executed her will. Daughter subsequently amended the trust on Date 7. Daughter died without issue on Date 8, after September 25, 1985, survived by Stepgrandchild 1 and the issue of Stepgrandchild 2: Stepgreatgrandchild 2a, Stepgreatgrandchild 2b and Stepgreatgrandchild 2c. Stepgrandchild 2 predeceased Daughter in Year.

Under Article III of the will, Daughter exercised her power of appointment over Father's Trust by directing that one-half of the corpus be distributed to the Stepgrandchild 1 Family Trust No. 2 and one-half to the Stepgrandchild 2 Family Trust No. 2, both established under the terms of Daughter's Trust. Daughter's Trust, as amended and restated, became irrevocable at her death, and provides for the disposition of Daughter's property. Any discretionary power over the disposition of property under Daughter's Trust is to be exercised by an independent trustee.

Section 5.02 of Article V of Daughter's Trust provides that property distributed pursuant to Daughter's exercise of the power of appointment under Article III of her will is to be divided equally between two trusts, Stepgrandchild 1 Family Trust No. 2 and Stepgrandchild 2 Family Trust No. 2. Stepgrandchild 1 Family Trust No. 2 is to be held in accordance with Article VII for the benefit of Stepgrandchild 1 and his issue and Stepgrandchild 2 Family Trust No. 2 is to be held in accordance with Article VII for the benefit of the issue of Stepgrandchild 2.

Section 7.05 of Article VII provides that the independent trustee at any time may create a "Separate Trust" and distribute to the Separate Trust, the whole or any part of the family trusts created under Article VII. The trustee is authorized to designate as income beneficiaries of such Separate Trusts a person or persons or a class of persons who at such time are, or if not living would be living, income beneficiaries of such family trusts. Article VIII of Daughter's Trust contains provisions governing any Separate Trust established by the independent trustee pursuant to section 7.05.

On Date 9, the independent trustee of Daughter's Trust, pursuant to section 7.05 of Article VII, created three separate trusts, Stepgreatgrandchild 2a Separate Trust No. 2 for the benefit of Stepgreatgrandchild 2a and his issue, Stepgreatgrandchild 2b Separate Trust No. 2 for the benefit of Stepgreatgrandchild 2b and her issue, and Stepgreatgrandchild 2c Separate Trust No. 2 for the benefit of Stepgreatgrandchild 2c and her issue. The trustee distributed one-third of the property from Stepgrandchild 2 Family Trust No. 2 to each of the trusts.

As discussed above, Article VIII of Daughter's Trust contains the provisions governing any Separate Trust created by the independent trustee. Under section 8.02 of Article VIII, as it applies to Stepgreatgrandchild 2a Separate Trust No. 2, the trust is to terminate, unless sooner terminated as provided in section 8.06, no later than the expiration of twenty-one years after the death of Stepgrandchild 1.

Under section 8.03, income of Stepgreatgrandchild 2a Separate Trust No. 2 may be distributed to or used or expended for the benefit of Stepgreatgrandchild 2a and his issue as the independent trustee shall determine. Each distribution, use or expenditure in accordance with the provisions of this section shall be in the sole discretion of the independent trustee.

Under section 8.04, accumulated income or corpus of the trust may be distributed to or used or expended for the benefit of Stepgreatgrandchild 2a and his issue as the independent trustee shall determine. Each distribution, use or expenditure in accordance with the provisions of this section shall be in the sole discretion of the independent trustee.

Under section 8.05, the independent trustee may grant the beneficiary of a separate trust the power, exercisable by will, to appoint the trust corpus to or for the benefit of such one or more persons, excluding the creditors and the estate of the beneficiary possessing the power. Under Article IX, section 9.03(H), the power of appointment must be exercised in a manner such that the trust property will vest no later than the expiration of 21 years after the death of Stepgrandchild 1.

Under section 8.06, Stepgreatgrandchild 2a Separate Trust No. 2 is to terminate prior to the time specified in Section 8.02 when and if the entire trust corpus has been distributed, used or expended pursuant to the prior provisions of Article VIII.

Under section 8.07, in the event the trust terminates at the time provided in section 8.02, the corpus is to be distributed outright to the beneficiaries as specified in section 8.07. The trust is to be administered under the laws of State.

It is represented that Stepgrandchild 1 was born on Date 2, prior to Date 3.

The independent trustee of Daughter's Trust requests a ruling that Daughter's testamentary exercise of the power of appointment which she held over Father's Trust, does not cause Stepgreatgrandchild 2a Separate Trust No. 2 to be subject to the generation-skipping transfer tax under § 2601.

Law and Analysis

Section 2601 imposes a tax on each generation-skipping transfer made by a transferor to a skip person.

Under section 1433(a) of the Tax Reform Act of 1986, the generation-skipping transfer tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under section 1433(b)(2)(A) of the Tax Reform Act and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the tax does not apply to a transfer from a trust, if the trust was irrevocable on September 25, 1985, and no addition (actual or constructive) was made to the trust after that date. Under § 26.2601-1(b)(1)(i), however, this rule does not apply to a transfer of property pursuant to the exercise, release, or lapse of a general power of appointment that is treated as a taxable transfer for estate or gift tax purposes. Under § 26.2601-1(b)(1)(ii), any trust in existence on September 25, 1985, will be considered irrevocable unless the settlor had a power that would have caused inclusion of the trust in his or her gross estate under §§ 2038 or 2042, if the settlor had died on September 25, 1985.

Section 26.2601-1(b)(1)(v)(A) provides that, except as provided under § 26.2601-1(b)(1)(v)(B), where any portion of a trust remains in the trust after the post September 25, 1985, release, exercise, or lapse of a power of appointment over that portion of the trust, and the release, exercise, or lapse is treated to any extent as a taxable transfer under chapter 11 or 12, the value of the entire portion of the trust subject to the power that was released, exercised, or lapsed is treated as if that portion had been withdrawn and immediately retransferred to the trust at the time of the release, exercise, or lapse.

Section 26.2601-1(b)(1)(v)(B) provides that the release, exercise, or lapse of a power of appointment (other than a general power of appointment as defined in § 2041(b)) will not be treated as an addition to a trust if – (1) such power of appointment was created in an irrevocable trust that is not subject to chapter 13 under §§ 26.2601-1(b)(1), and (2) in the case of an exercise, such power of appointment is not exercised in a manner that may postpone or suspend the vesting, absolute ownership or power of alienation of an interest in property for a period, measured from the date of creation of the trust, extending beyond any life in being at the date of creation of the trust plus a period of 21 years.

Section 26.2601-1(b)(4)(i) provides rules for determining under what circumstances judicial actions, settlements, trustee actions and trust modifications will not cause a trust created before September 25, 1985, to lose exempt status.

Section 26.2601-1(b)(4)(i)(A) provides that the distribution of trust principal from an exempt trust to a new trust or retention of trust principal in a continuing trust will not cause the new or continuing trust to be subject to the generation-skipping transfer tax if – (1) either – (i) the terms of the governing instrument of the exempt trust authorize distributions to the new trust or the retention of trust principal in a continuing trust, without the consent or approval of any beneficiary or court; or (ii) at the time the exempt trust became irrevocable, state law authorized distributions to the new trust or retention of principal in the continuing trust, without the consent or approval of any beneficiary or court; and (2) the terms of the governing instrument of the new or continuing trust do not extend the time for vesting of any beneficial interest in the trust in a manner that may postpone or suspend the vesting, absolute ownership, or power of alienation of an interest in property for a period, measured from the date the original trust became irrevocable, extending beyond any life in being at the date the original trust became irrevocable plus a period of 21 years, plus if necessary, a reasonable period of gestation.

Section 26.2601-1(b)(4)(i)(E), Example 1, illustrates the application of paragraph (b)(4) as follows:

Trustee's power to distribute principal authorized under trust instrument. In 1980, Grantor established an irrevocable trust for the benefit of Grantor's child, A, A's spouse, and A's issue. At the time the trust was established, A had two children, B and C. A corporate fiduciary was designated as trustee. Under the terms of the trust, the trustee has the discretion to distribute all or part of the trust income to one or more of the group consisting of A, A's spouse or A's issue. The trustee is also authorized to distribute all or part of the trust principal to one or more trusts for the benefit of A, A's spouse, or A's issue under terms specified by the trustee in the trustee's discretion. Any trust established under the trust, however, must terminate 21 years after the death of the last child of A to die who was alive at the time the trust was executed. The trust will terminate on the death of A, at which time the remaining principal will be distributed to A's issue, per stirpes. In 2002, the trustee distributes part of the trust's principal to a new trust for the benefit of B and C and their issue. The new trust will terminate 21 years after the death of the survivor of B and C, at which time the trust principal will be distributed to the issue of B and C, per stirpes. The terms of the governing instrument of the trust authorize the trustee to make the distribution to a new trust with the consent or approval of any beneficiary or court. In addition, the terms of the governing instrument of the new trust do not extend the time for vesting of any beneficial interest in a manner that may postpone or suspend the vesting, absolute ownership or power of alienation of an interest in property for a period measured from the date of creation of the trust, extending beyond any life in being at the date of creation of the trust plus a period of 21 year, plus if necessary, a reasonable period of gestation. Therefore, neither the trust nor the new trust will be subject to the provisions of chapter 13 of Internal Revenue Code.

Section 2041(a)(1) provides, in part, that the gross estate shall include the value of all property with respect to which a general power of appointment created on or before October 21, 1942, is exercised by the decedent through his will or by a disposition which, if it were a transfer of property owned by the decedent, such property would be includible in the decedent's gross estate under §§ 2035 through 2038, inclusive. The failure to exercise such a power or the complete release of such a power will not be deemed an exercise of that power.

Section 2041(a)(1)(i) provides that if a general power of appointment created on or before October 21, 1942, has been partially released so that it is no longer a general power of appointment, the exercise of the power will not be deemed to be the exercise of a general power of appointment, if the partial release occurred before November 1, 1951.

Section 2041(b) provides that a general power of appointment is a power which is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate, except where the decedent's power is limited by an ascertainable standard relating to the health, education, support, or maintenance of the decedent.

In the present case, Father's Trust became irrevocable prior to September 25, 1985. Daughter's power of appointment with respect to Father's Trust was created prior to October 21, 1942. The power, as originally created, constituted a general power of appointment as described in § 2041(b). However, prior to November 1, 1951, Daughter partially released the power so that, after the release, the power was not a general power. In accordance with § 2041(a)(1)(i), Daughter's testamentary exercise of the power is not treated as the exercise of a general power for estate tax purposes.

Under Daughter's will, Daughter exercised her power of appointment over Father's Trust by directing that the property subject to such power be distributed one-half to the Stepgrandchild 1 Family Trust No. 2 and one-half to the Stepgrandchild 2 Family Trust No. 2. The independent trustee of Daughter's Trust, pursuant to express authorization in the trust instrument, established a separate trust, Stepgreatgrandchild 2a Separate Trust No. 2, for the benefit of Stepgreatgrandchild 2a and his issue. Stepgreatgrandchild 2a Separate Trust No. 2 or any trust created pursuant to the exercise by a trust beneficiary of a special power of appointment granted by the independent trustee, must terminate no later than the expiration of twenty-one years after the death of Stepgrandchild 1. As noted above, Stepgrandchild 1 was alive prior to the date that Father's Trust became irrevocable. Thus, Daughter's power was not exercised in a manner that may postpone or suspend vesting of the trust corpus passing to Stepgreatgrandchild 2a Separate Trust No. 2 for a period measured from the date of creation of Father's Trust extending beyond any life in being plus 21 years. Section 26.2601-1(b)(1)(v)(B). Similarly, the creation by the independent trustee of Stepgreatgrandchild 2a Separate Trust No. 2 did not cause the trust to lose exempt status for GST tax purposes. See § 26.2601-1(b)(4)(i)(E), Example 1.

Accordingly, based on the facts submitted and representations made, Daughter's exercise of the power of appointment which she held over Father's Trust does not cause Stepgreatgrandchild 2a Separate Trust No. 2 to be subject to the generation-skipping transfer tax under § 2601.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for the rulings, it is subject to verification on examination.

Except as specifically ruled herein, we express no opinion on the federal tax consequences of the transaction under the cited provisions or under any other provisions of the Code.

In accordance with the power of attorney on file with this office, we are sending a copy of this letter to the independent trustee of Stepgreatgrandchild 2a Separate Trust No. 2.

The ruling is directed only to the taxpayers requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely yours,

George L. Masnik
Chief, Branch 4
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure
Copy for section 6110 purposes

cc: